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As I see

THE EFFECT OF TIGHT MONEY ON REAL ESTATE

WHEN the Federal Government finds it necessary to pay 4% or better to borrow money on 91-day Treasury bills, and more than 4-3/4% on Treasury bills for 6 months, mortgage interest rates are bound to rise.

There is some chance that we have not yet seen the end of the rise in short-term interest rates, as the Federal Government during the next 12 months must refinance $78 billion worth of Government debt. The failure of Congress to raise the permissible rate on long-term debt means that this refinancing must be done in a short-term market, and this $78 billion does not include anything except the refinancing of past debt. It seems to me that this amount cannot be raised with the present rates for short-term money, unless the Federal Reserve re-enters the market, buying up those short-term Governments which cannot otherwise be sold at that interest rate. For the Federal Reserve to follow this policy would be to surrender to positive and rapid inflation. If this policy is continued for a period long enough to be of any value, it will depreciate the value of the dollar at a more rapid rate than it declined during the war and postwar period. It will destroy the purchasing power of accumulated savings, of insurance policies, and of retirement funds.

As long as the present Administration stays in power I believe that we will continue to hold the line against further inflationary practices, but this means that interest rates will be high in terms of the rates of the past 25 years.

The long chart in this bulletin can be used to see our present situation in perspective. How have high interest rates affected real estate in the past? Can new building be done in volume with a high mortgage rate? Will older properties change hands when the mortgage interest rate is considerably higher than it has been in the last few years?

This chart seems to give considerable encouragement to the belief that neither the volume of building nor the number of transfers per 10,000 families is primarily dependent upon the rate of interest. The narrow blue dotted line showing mortgage interest rates in St. Louis from 1892 to the present indicates that in the 44 years from 1892 to 1936 mortgage interest rates were above 5-3/4% more than 86% of the time.

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REAL ESTATE TRANSFERS
PER 10,000 FAMILIES
PREVAILING RATES ON
PRIME COMMERCIAL PAPER
4-TO-6 MONTHS
NUMBER OF TRANSFERS PER 10,000 FAMILIES
211
252
233
RAILROAD BOOM
SPANISH AMERICAN WAR
1907 PANIC
WORLD WAR I
MONEY VERY TIGHT
MONEY VERY TIGHT
MONEY RATES FIRM TIGHTENING IN AUTUMN
EASY MONEY TIGHTENS
MONEY MARKET GRADUALLY TIGHTENS
MONEY TIGHT
MONEY TIGHTENS IN AUTUMN
TIGHT MONEY
VERY TIGHT MONEY
MONEY TIGHTENS IN AUTUMN
FAIRLY TIGHT MONEY
TIGHT IN AUTUMN
TIGHT MONEY
TIGHT MONEY
260
240
220
200
180
160
140
120
100
80
60
40
20
0
1875
1880
1885
1890
1895
1900
1905
1910

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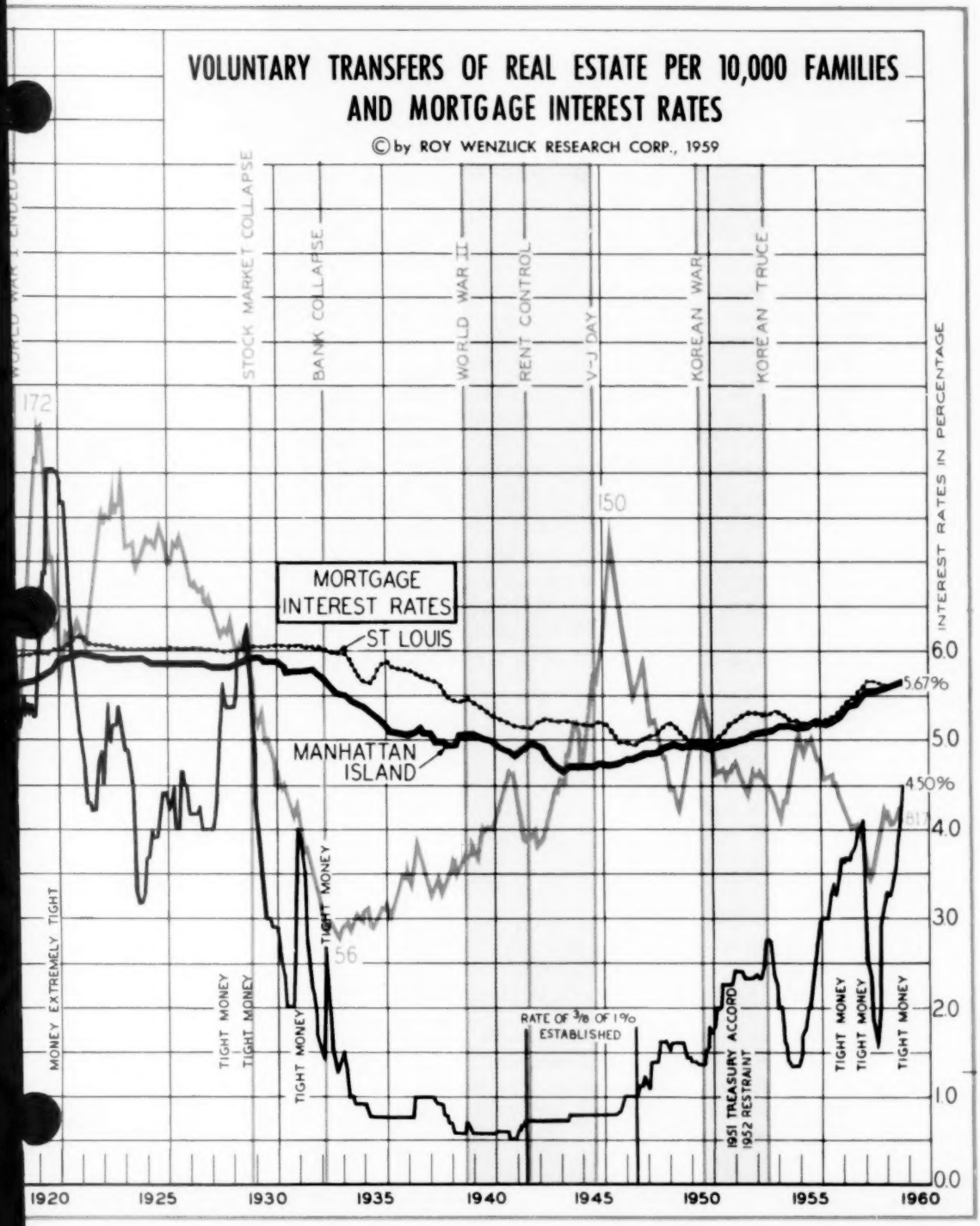

Only in the past 23 years have we experienced the low rates resulting from definite intentional inflationary practices on the part of the Federal Government. During this period our dollar has lost 52% of its purchasing power.

This chart shows that real estate transfers were considerably higher in the early 1890's than they are today, when interest rates were 6% or higher and when money was very tight. During at least the second half of the boom of the early 1900's, interest rates were more than 5-3/4%. During all of the boom of the 1920's, mortgage interest rates averaged 6% or higher.

The heavy solid blue line on this chart shows mortgage interest rates in New York City. This line varies from the blue dotted line in that practically all mortgages made in New York City are on larger properties, while practically all mortgages made in St. Louis are on single-family residences. New York mortgage interest rates are generally lower, too, because the largest total of lendable funds clears through New York financial institutions, and there is always a tendency for a financial institution to prefer to lend in its own community, where it can watch, more closely, the property on which it has loaned funds. Through the effect of supply and demand this generally results in lower mortgage interest rates in financial capitals than in areas far removed from big aggregations of funds.

If we consider the effect of 6% mortgage money on new residential building, we immediately find some rather peculiar facts. According to the figures compiled by our company on residential building in cities of the United States, we find that, during the boom of the 1920's, when the mortgage interest rate averaged 6%, we reached peaks in accordance with the following.

PEAK RESIDENTIAL BUILDING RATE IN THE 1920's AND IN THE 1950's
(Units per 10,000 Families per Month)

Size of Metropolitan Area	Peak Rate in 1920's	Rate in 1950	% change
1,000,000 and over	45.0 in 1923	32.7	-27
500,000 to 1,000,000	45.3 in 1925	37.3	-18
200,000 to 500,000	44.0 in 1925	31.9	-28
50,000 to 200,000	27.9 in 1923	29.5	+6
All Metropolitan Areas	36.3 in 1925	32.8	-10
Mortgage Interest Rate	6+%	5%	-18

At the time these peaks were reached in the 1920's there was no provision for guaranteeing or insuring mortgages, as this was before the time of FHA, Fannie Mae, and the Veterans Administration guarantees.

I think it might be entirely possible that the first result of the tight money situation might be to discourage some real estate activity in older properties and some new building. Apparently, however, in the past, both activity and building have been able to adjust themselves to practically any rate which was current at the time. This will probably be the case again.

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